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SUBJECT: KAZAKHSTAN AND AZERBAIJAN SIGN ENERGY AGREEMENTS

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(B) ASTANA 1400

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¶1. (U) Sensitive but unclassified. Not for public Internet.

¶2. (SBU) SUMMARY: On October 2, during President Nazarbayev's visit to Baku, the national oil companies of Kazakhstan and Azerbaijan signed three documents on energy cooperation. The agreements do not preclude the participation of international oil companies (IOCs), but they signal that SOCAR and KMG are prepared to move forward with oil transportation projects, even without IOC shipping commitments. END SUMMARY.

KMG AND SOCAR SIGN OIL TRANSPORTATION AGREEMENTS

¶3. (SBU) On October 2, the State Oil Company of Azerbaijan (SOCAR) and Kazakhstan's national oil company KazMunaiGas (KMG) agreed to use Azerbaijani infrastructure to transport Kazakhstani oil, to conduct a joint feasibility study of the marine portion of the Kazakhstan Caspian Transportation System (KCTS), and to explore alternative options to move Kazakhstani oil from Baku to Black Sea ports, including the Georgian ports of Kulevy and Batumi. The agreements come less than three weeks after President Nazarbayev hosted a summit in Aktau for the presidents of Russia, Azerbaijan, and Turkmenistan (reftel A).

¶4. (SBU) KCTS will require a new, 500-kilometer pipeline from Eskene to Kuryk, new oil-loading terminals on the Kazakhstani coast of the Caspian Sea, large tankers and support vessels, new oil-unloading terminals on the Azerbaijani coast of the Caspian Sea, and new pipelines to the Baku-Tbilisi-Ceyhan system. Initially, the system is expected to transport 500,000 barrels of oil a day (23 million tons a year) with expansion to 750,000-1,200,000 barrels a day (35-56 million tons a year). Negotiations between KMG and the IOCs have stalled over ownership and operational issues related to the Eskene-Kuryk pipeline (reftel B).

A NEW BLACK SEA PIPELINE?

¶ 15. (SBU) The memorandum of intent to cooperate on Baku-Black Sea oil transportation mentions the possibility of constructing, on a parity basis, a new pipeline from the Caspian coast near Baku to the Black Sea coast, in order to transport Kazakhstani oil through Azerbaijan. Kazakhstani officials have long advocated for access to the Baku-Supsa pipeline, without success.

¶ 16. (U) On October 2, Azerbaijani President Ilham Aliyev told reporters that Azerbaijan and Kazakhstan "maintain an active dialogue on a wide range of issues. Our two countries are implementing a number of projects together," he said, "and we have high hopes for their success." President Nazarbayev said that "there are no unresolved problems, differences or friction in relations between Kazakhstan and Azerbaijan."

IOCS SHOULD NOT BE CONCERNED . . .

¶ 17. (SBU) Dan Mihalik, an American citizen with more than 12 years of experience in Kazakhstan's oil and gas industry, is currently an advisor to Italy's Agip and a member of the Board of Directors of KazTransOil. On October 4, Mihalik told Energy Officer that, as a Board Member of KTO, he was very happy that SOCAR and KMG agreed to conduct the KCTS feasibility study independently. "This is fully consistent with the strategy that Kazakhstan has been pursuing for the last 12 years, and from their perspective, it is absolutely the right thing to do." Mihalik said the joint agreement is good for the diversification of Kazakhstan's oil transportation routes, and does not doubt KMG and SOCAR's technical expertise to carry out the work. When asked about the implications of the agreement for IOC participation in the KCTS project, Mihalik was unconcerned, "This should not be a major issue for them. They don't want to be in the marine transportation business. They don't want to own the

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terminals and the tankers." Mihalik said that the next major step will be to secure shipping commitments from the IOCs, but he asserted that recent agreements between SOCAR and KMG would adversely affect the IOC's negotiating position.

BUT SOME ARE SKEPTICAL

¶ 18. (SBU) On October 5, Jay Johnson, Managing Director for Chevron's Eurasia Business Unit, told Energy Officer that KMG's agreement to conduct a joint feasibility study with SOCAR is part of KMG President Kairgeldy Kabyldin's "drive to develop an entirely government-owned transportation corridor" across the Caspian. He said Kabyldin is not under any time pressure to build KCTS, whereas the IOCs are eager to plan an evacuation route for anticipated Kashagan volumes. Johnson said KMG and SOCAR have neither the capital nor the expertise to build the system without IOC participation. He said the amended Kashagan contract includes ship-or-pay commitments, but since Chevron is not part of the Kashagan consortium, he did not know whether or not these commitments could be invoked to construct KCTS, or whether the funds would be sufficient to cover the cost of building the system. Johnson said he would not be surprised if the agreements between KMG and SOCAR were part of a ploy to cut out U.S. producers and ship Kashagan oil to Iran. He said that Iran offers the most attractive alternative from a strictly commercial point of view, and only Iran has the large tankers and ship-building capacity to transport the large volumes of crude necessary to make KCTS commercially viable.

¶ 19. (SBU) COMMENT: Since his speech on Caspian issues at the Russian port of Astrakhan on August 17, Russian President Dmitri Medvedev has lobbied for increased energy cooperation with the leaders of other Caspian states in Orenburg (September 10), Aktau (September 12), and Turkmenbashi (September 13). Yet, despite Medvedev's clear attempt to set the agenda for other Caspian states, Nazarbayev and Aliyev demonstrated on October 2 that the presidents of the region can and will act independently, even on projects that Russia likely opposes. Although representatives of the national oil companies of Azerbaijan and Kazakhstan signed the agreements, Nazarbayev and Aliyev's personal involvement advanced the process. We expect the IOCs to advise and consult SOCAR and KMG on the feasibility study. They must also provide ship-or-pay volume

commitments, or direct financing, before the system can be built. We therefore view the October 2 agreements as a good sign for KCTS. Presidential support is advantageous for the project and for the IOCs, because ultimately only the presidents of Kazakhstan and Azerbaijan can make the final decisions needed to complete the project.

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